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How Urban Households in Central America Responded to the Recent Global Crises

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IFPRI Issue Brief 67 • January 2011



A review of various economic indicators shows that both the recent food crisis and the financial and economic crisis have had significant negative effects on the Central American countries. The first jolt to the region came in 2007 and mid-2008, while the second occurred at the end of 2008 and in 2009. Particularly notable during 2007 and the first half of 2008 was the inflation that hit the food and beverage sector, which consistently outpaced overall inflation in Central America. The rise in prices coincided with the upward trend in international prices for the main agricultural commodities. The impact of the financial and economic crisis was reflected in declining exports, particularly for the *maquila* industry, reduced tourist inflows, a decrease in remittances from abroad, and a decline in flows of foreign direct investment (FDI) to the region. These factors, in combination, contributed to a contraction of economic activity in Central America in 2009.

This brief analyzes the impact of both crises on urban households using both quantitative and qualitative methods for four Central American countries: El Salvador, Guatemala, Honduras, and Nicaragua. First, behavior of different economic aggregates in the region's countries during the period examined and the potential implications for households are examined. This section is followed by a simulation analysis of the effects of the food price crisis on the well-being and poverty rates of urban households. The final section presents findings from an in-depth qualitative analysis of focus-group material on the impact of the food and financial and economic crises, collected between the end of 2009 and the beginning of 2010 from a diverse sample of the urban populations in these four countries. The qualitative nature of this analysis provides for a more detailed understanding, from a microeconomic perspective, of how households in the region dealt with the crises.

MACROECONOMIC ENVIRONMENT

Food price crisis

Beginning in 2007, food prices in El Salvador, Guatemala, Honduras, and Nicaragua began to rise at a rate consistently higher than the rise in the Consumer Price Index (CPI). This was a departure from previous years, when the increase in food prices was roughly in line with increases in the CPI. Moreover, the highest rates of inflation in the price index for the food and beverage sector occurred nearly simultaneously in the four countries, around the end of the second quarter and beginning of the third quarter of 2008 (see Figure 1). In El Salvador, inflation in food prices peaked in August 2008 (17.5 percent); in Guatemala, in June 2008 (18.9 percent); and in Honduras, in July 2008 (24.3 percent). For Nicaragua, according to available information up to April 2008, inflation reached its highest point (27.4 percent) in that month. This coincides with the peak in international prices for the main agricultural commodities: wheat, corn, rice, and soy. Together, these facts confirm that the global food crisis led to higher domestic food prices in the four countries being considered here.

One could therefore expect that the poorest households in urban areas would be hit hardest by the rise in food prices, given that the poorest quintiles of the population devote a greater proportion of their spending to food purchases. In the four countries studied here, the proportion spent on food by the poorest quintile of urban households was more than 50 percent, with the figure rising as high as 65 percent in El Salvador. This proportion gradually declines as one reaches quintiles with higher per capita income or expenditures.

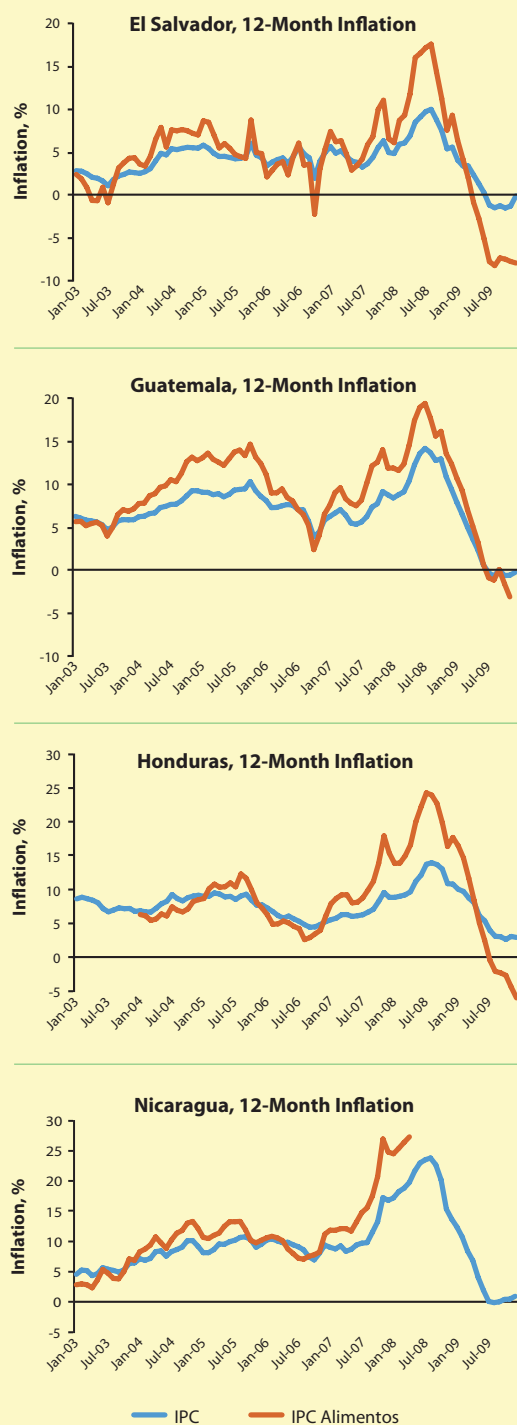
Financial and economic crisis

The financial and economic crisis struck Central America through three distinct pathways. First, external demand contracted, whether due to a drop in exports—particularly to the United States from the *maquila* sector—or as a result of decreased tourist inflows as a consequence of the worldwide recession. Second, remittances declined because of the effects the recession in the United States had on Central American workers and their capacity to send money back to their countries of origin. Third, FDI flows declined owing to the international financial and economic crisis, which constricted investment flows to developing countries in the region.

In short, in the four countries involved in this study, there was an overall slackening toward the end of 2008 and a decline in 2009 in (1) total exports (including those from the *maquila* industry), (2) number of international visitors, (3) amount of remittances received, and (4) inflows of FDI. Figure 2 displays, for example, that up until the third quarter of 2009, all four countries showed a drop of up to 20 percent in their total exports compared with the same quarters of 2008. The case of remittances is similar: In both El Salvador and Guatemala, remittances began to fall gradually beginning in the last quarter of 2008, reaching year-on-year rates of change between -10 percent and -12 percent. A similar situation occurred in Honduras and Nicaragua starting in the first quarter of 2009, although in Honduras these rates fell as low as 17 percent in the third quarter of 2009.

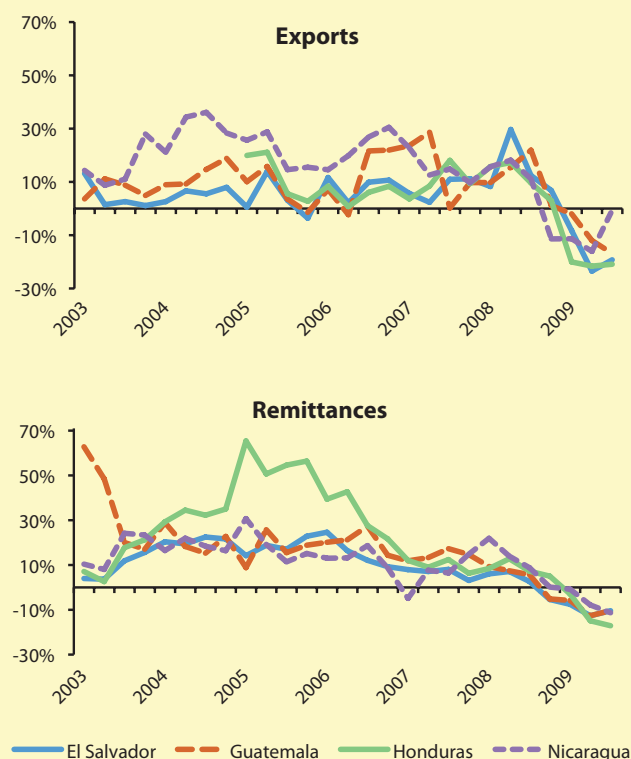
A simulation exercise confirmed that the figures for exports, remittances, and FDI were far below the figures projected for

Figure 1—Overall inflation and inflation in food prices



Sources: General Directorate of Statistics and Censuses of El Salvador (<http://www.digestyc.gob.sv/>); National Institute of Statistics of Guatemala (<http://www.ine.gob.gt/>); Central Bank of Honduras (<http://www.bch.hn/>); Central Bank of Nicaragua (<http://www.bcn.gob.ni/>).

Figure 2—Year-on-year change in quarterly exports and remittances



Source: Executive Secretariat of the Central American Monetary Council, Central Bank of Honduras.

Table 1—Simulated change in exports and remittances by quarter, in percent

	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3
TOTAL EXPORTS					
El Salvador	6.5	0.9	-13.0	-27.3	-23.3
Guatemala	12.5	-7.1	-9.4	-18.3	-22.8
Honduras	1.1	-5.4	-25.8	-27.0	-26.6
Nicaragua	-1.5	-21.5	-20.7	-24.8	-10.8
REMITTANCES					
El Salvador	-6.7	-13.6	-15.8	-19.8	-17.9
Guatemala	-5.5	-15.0	-15.8	-21.0	-19.0
Honduras	-6.7	-8.4	-15.2	-25.0	-26.6
Nicaragua	-1.2	-8.7	-9.5	-15.8	-18.8

Source: Authors.

a scenario with no global financial and economic crisis.¹ Table 1 shows the percentage difference between the amounts of exports and remittances seen in each country after the onset of the crisis (the third quarter of 2008) and the expected corresponding amounts projected on the basis of trends prior

to the crisis, obtained using econometric estimates.² The impact on exports and remittances from abroad was substantial. In El Salvador, for example, remittances in the third quarter of 2008 were 7 percent lower than expected for the period and 18 percent lower than expected in the third quarter of 2009.

QUALITATIVE ANALYSIS: BEYOND THE NUMBERS

Methodology

In order to study the qualitative impact of the crisis, 12 group sessions were conducted in the four countries, consisting of approximately 10 people per group. The sessions were held in San Salvador, Guatemala City, Tegucigalpa, and Managua between December 2009 and January 2010. The distribution of the sessions was determined on the basis of certain interest groups that were considered appropriate and relevant to interview, while also making an effort to maintain a degree of representativeness of the economically active population in urban areas in terms of job status, gender, age, and type of economic activity.

The 12 group sessions were distributed as follows:

Table 2—Distribution of group sessions

Session 1	Session 2	Session 3
Homemakers socioeconomic strata A/B	Homemakers socioeconomic strata C/D	Heads of household (man) whose household receives remittances
Session 4	Session 5	Session 6
Heads of household (woman) whose household receives remittances	Employed women, of which 2–3 were own-account workers	Unemployed, 5 men and 5 women
Session 7	Session 8	Session 9
Tradable sector own-account workers	Nontradable sector own-account workers	Wage earners, tradable sector, age 18–44
Session 10	Session 11	Session 12
Wage earners, tradable sector, age 45+	Wage earners, nontradable sector, age 18–44	Wage earners, nontradable sector, age 45+

Source: Authors.

The analytical guide for the focus groups was designed to address specific areas of interest relevant to the participants, as well as to corroborate or refute various hypotheses that have been proposed regarding the potential effects of the crises on households. Thus, the first section of the guide deals with the food crisis and the second with the financial and economic crisis. In the case of the former, particular attention is devoted to the following: general perception, spending on food, substitution effect, redistribution within the household, long-term effects, and government response. In the case of the latter (the financial and economic crisis), areas of interest include the following: employment and income, spending and investment, migration/remittances, savings and credit, social

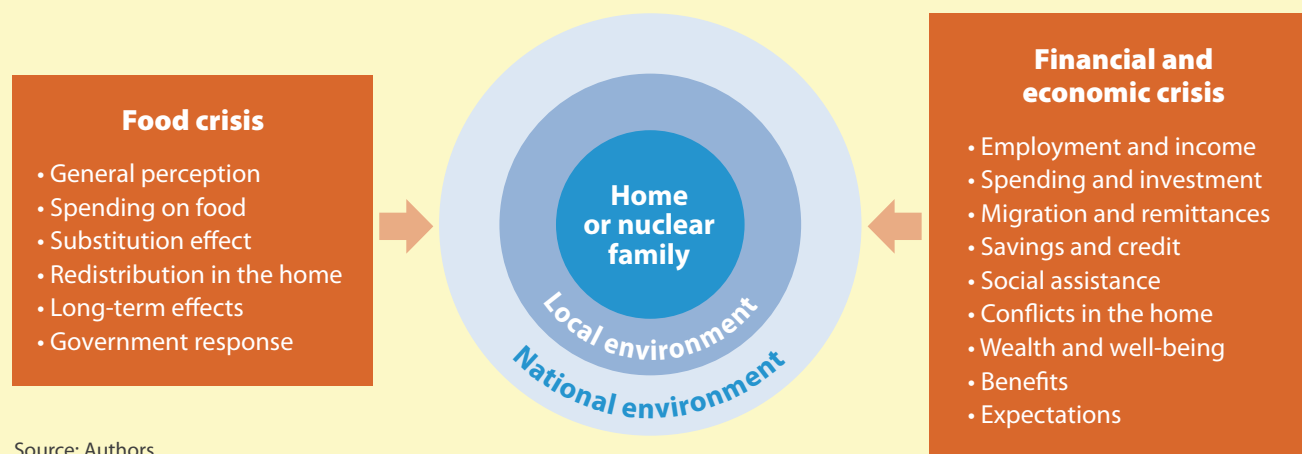
Thus, it is logical to conclude that the crisis led to the closure of numerous businesses, an increase in unemployment and underemployment, and a deceleration or contraction in the region's economies. The economies of the four countries showed a deceleration in economic activity in the second half of 2008 and a decline in 2009. Other effects of the crisis that were evident in 2009 include a drop in the inflation rate, a decline in interest rates, lower savings levels, and greater personal indebtedness, along with declining tax revenues.

QUANTITATIVE ANALYSIS: A SIMULATION OF FOOD PRICE CRISIS IMPACTS

In each of the four countries studied, researchers estimated the net loss of real income experienced by urban households as a result of the rise in domestic food prices between the first quarter of 2006 and the first quarter of 2008. This quantitative analysis took into account the fact that households do not remain passive in the face of price changes and tend to replace more expensive foods with those that are less costly. Thus, food demand elasticity—or, coefficients that measure the percentage change in demand as a function of changes in price—was also estimated.³ The results of the simulations conducted show the following:

- In *El Salvador*, urban households lost an average of 1.5 percent of their real purchasing power. In the poorest urban quintile, the estimate grew to nearly 3.0 percent. Although available information does not provide a means of identifying households that may have benefited, it can be assumed that, as in other countries of the region, nearly all households suffered losses. Simulations indicate that urban poverty increased by as much as 1.3 percentage points.
- In *Guatemala*, 99.4 percent of urban households were negatively affected by the rise in food prices. On average, these households experienced increased food prices and at the same time saw a decline in their real purchasing power equivalent to 2.0 percent of total family spending. Among the poorest 20 percent of urban households, this loss was 2.5 percent. Urban poverty is estimated to have grown by 1.1 percentage points.
- In *Honduras*, 98.4 percent of urban households showed declines in real income. On average, these losses were approximately 2.4 percent of family spending. For the poorest 20 percent of urban households, the loss was estimated at 3.2 percent, while urban poverty was estimated to have increased by 1.6 percentage points.
- In *Nicaragua*, households that were negatively affected by the crisis (98.5 percent of all urban households) lost an equivalent of 7.1 percent of their purchasing power. In the case of the poorest 20 percent of urban households, this loss was estimated at 8.5 percent. Simulations indicate that urban poverty increased by 5.5 percentage points.⁴

Figure 3—Issues addressed and realms affected



Source: Authors.

assistance, conflicts in the home, wealth/well-being, benefits, expectations, and national environment.

The guide was also designed to distinguish the different realms in which the participants have felt the effects of the crisis. These include the participant's home or nuclear family, the person's local environment (workplace, extended family, and neighborhood), and the national environment. Figure 3 summarizes the different issues addressed and the realms affected.

The qualitative analysis of the group sessions highlights the consensus of opinion that exists among the participants of nearly all of the focus groups, both within each country and from one country to another. This pattern suggests that the food crisis and, particularly, the financial and economic crisis, had very similar effects across urban segments in each of the countries. The principal findings regarding the impact of both crises are listed by issue in the following sections.⁵

General perception: In all of the four countries, those interviewed recall unusual increases in prices around the end of 2007 and in the first half of 2008. This relates particularly to the sharp rise in the price of basic foods such as tortillas, bread, milk, and meat. A number of interviewees associated the rise in food prices with contemporaneous increases in the price of gasoline.

Spending on food: Many of those interviewed stated that they had been forced to increase their total food spending because of the rise in prices; in some cases, food purchases represented as much as three-quarters of household spending.⁶ One constant in all of the countries and among most of the socioeconomic strata was the notion that there was no way of significantly reducing total food consumption, given that, one way or another, "one has to eat."

Substitution effect: In general, urban households adopted two different strategies to protect against the rise in food prices. First, families sought to replace certain foods with others. This involved buying lower-quality brands of products, reducing consumption of more expensive foods (such as meat) or replacing them with less costly ones (vegetables and stews), and taking greater advantage of sales and discounts (particularly those offered at supermarkets). Second, many families began reducing their consumption of other goods (negative income effect) in order to avoid having to make significant sacrifices in food consumption. Thus, there were major reductions in spending on entertainment and recreation among households where such spending had previously occurred.

Redistribution within the household: Regardless of socioeconomic status, most of the urban households had serious concerns about feeding their children. A commonly voiced view was that food for children cannot be sacrificed under any circumstances, and that, where necessary, cutbacks in consumption would be made among adults who are in good health.

Long-term effects: Upon inquiring about possible long-term effects of the rise in food prices—for example, weight loss,

IMPACTS OF THE FOOD PRICE CRISIS

"You spend more but buy less."

—Woman whose household receives remittances, Guatemala City

"You don't stop eating. We're just eating less. Less milk, less meat than before."

—Homemaker from socioeconomic strata C/D, Managua

"Before, where I'd buy a bottled juice, now I don't, because it costs too much. Instead I buy some fruit and make fresh juice."

—Homemaker from socioeconomic strata A/B, Tegucigalpa

increased illnesses among household members, poor performance in school—no evidence was found of a common link. In a very few cases of low-income individuals, some of these effects were reported, but this was more the exception than the rule.

Government response: Only a small percentage of people interviewed stated that they had received some direct government assistance to offset the rise in food prices. Quite a number of interviewees indicated that they knew of assistance programs operating in rural areas or in the poorest urban neighborhoods, but the perception was that such programs were not widespread. The programs most widely known by those interviewed operated through schools.

IMPACTS OF THE FINANCIAL AND ECONOMIC CRISIS

“My son worked at a business. He worked as a regular employee, but they stopped giving him bonuses and vacations several months ago.”

—Unemployed person, Guatemala City

“Before, they’d send me 200 dollars from abroad, now they send me 80 or 100 dollars. Before, they’d send me money twice a month, every two weeks, now it’s once a month.”

—Man whose household receives remittances, San Salvador

“Before, you’d save the bonus, now it’s gone in no time; sometimes you even end up owing that same amount.”

—Wage earner, tradable sector, age 45+, Tegucigalpa

Employment and income: Many of the participants indicate that they have been directly or indirectly affected by the job cutbacks or business closures resulting from the crisis. In several cases, someone in the participants’ households or in their local environment (a close relative, neighbor, or friend) had lost a job. Among those who had worked or were working in a business, whether in the tradable or nontradable sector, many have witnessed massive layoffs. Many of those who lost their jobs have not yet managed to find new work.⁷

Another recurring issue among wage earners was the “informalization” of labor relations. Apparently, while some companies reduced their staffing, others decided to keep on some of their employees but under less favorable working conditions. Among firms that maintained their employment levels, cases of wage cuts, reduced work hours, nonrecognition of overtime, and the elimination of bonuses and other job benefits were reported. Workers have been forced to accept these changes for lack of alternative work options.

There is a distinction in the way own-account workers have been affected. Entrepreneurs who have medium or large businesses indicate that they have managed to survive the crisis; this is particularly true of those linked to the nontradable sector, although they, too, have been compelled to cut back staff and postpone any investment plans due to declining sales and the inability to collect amounts owed by clients. Among small- or micro-entrepreneurs, there was a consensus that, in addition to cutbacks in personnel, they began to use their installed capacity to offer other products and services or to barter as a form of payment.

Notably, participants from the different groups reported an increase in the number of small informal businesses, particularly those related to retail trade and food sales, due to job losses and the lack of opportunities for formal employment. This pattern, along with the apparent changes in labor relations between companies and their workers, suggests that the crisis has led to higher levels of informality in the economy.

Spending and investment: The losses of jobs and reductions in income have forced many urban households, particularly in the lowest socioeconomic classes, to adjust their spending. Examples of this include changes to cell phone service—moving from contract plans to pre-paid plans—and reductions in family outings. Households struggling to pay for services commonly practiced *chinea*, in which they pay only one basic service bill per month, thereby deferring payment of another bill. Other adjustments included switching a child’s school or university to a lower-cost educational institution.⁸ In medium and high socioeconomic strata, there were fewer adjustments in spending, with changes limited largely to reducing costs associated with travel, memberships in clubs and organizations, gym fees, and the purchase of cosmetics, along with postponing home-remodeling projects and purchases of certain durable goods, such as automobiles.

Migration and remittances: Most of the participants who know migrants or who have a family member who has migrated indicated that the migrants had experienced difficult times as a result of either losing their jobs or having to work under harsher conditions. As a result, the amount and frequency of remittances from abroad had dropped significantly. Several people pointed out that relatives or acquaintances abroad are returning home. Despite the crisis, however, some focus-group participants suggested that they would prefer to leave their country rather than remain; they perceived that people in general would also prefer to leave.⁹ Many believe that there are better opportunities outside their country than within it.

Savings and credit: Although it was not uncommon for participants, regardless of socioeconomic status, to have had the habit of saving some money two or three years previously, they indicated that it had recently become practically impossible to do so. The few people who tried to save money ended up using it for other purposes such as medical emergencies and unforeseen expenses. Others have even depleted the savings they accumulated in prior years. In the highest socioeconomic strata, saving continues, but at lower levels.

Many of the participants stated that the banks had restricted their lines of credit and that interest rates had risen. They also were in agreement that credit card debt carries high risks, given their current economic situations. In short, participants, particularly those in the medium and low socioeconomic strata, have significantly reduced their installment purchases.

A number of participants used personal loans as a type of informal credit. This has been a means of helping relatives who are in even more difficult economic straits. Certain participants have benefitted as the recipients of such assistance. The practice of *chineo* has also served as a type of short-term credit: Money earmarked for paying a given service bill is used to pay other debts that are due or about to become overdue, with plans to return the funds to their originally intended purpose the following month. The late-payment penalties associated with services are much lower than the interest and penalties charged by banks and credit card issuers.

Social assistance: Apart from the food assistance programs cited earlier, almost none of the participants could identify—much less have benefited from—any social assistance program sponsored by the government or other institutions to help deal with the financial and economic crisis. Where such assistance existed at all, it was targeted to rural areas and urban areas of extreme poverty.

Conflicts in the home: In general, the crisis has altered the general mood within families. Participants from several groups reported that personal relationships between household members, particularly couples, had deteriorated as a result of the worsening economic situation. Ill feelings and stress have become the norm. Conversations among couples often turn into complaints and mutual accusations as to who is responsible for the dismal state of affairs.

Wealth and well-being: Most participants believed that their current economic situation is worse or considerably worse than in 2007. This negative view was prevalent in most groups.

Benefits: Many participants found it difficult to clearly identify who benefited from the crisis, at least in urban areas in their respective countries.

Expectations: Responses regarding participants' personal futures and the futures of their families in the coming years contrasted sharply with the general pessimism surrounding the economic crisis. Contrary to what might be expected, the upcoming years were seen in most of the groups as years of economic improvement. It is difficult, however, to separate participants' desires for the future from expectations based on objective analysis.

National environment: At the country level, all participants agreed that their respective countries have been through difficult times in the last two years. Among other indicators, they pointed to the steep rise in prices; the severe effects of the crisis on the apparel *maquila* industry, tourism, and construction (as the hardest hit sectors); the reduced purchasing power of households; the increase in poverty; the desirability of migration

despite the crisis; the large number of households that have been affected by the reduction in remittances from abroad; the lack of any significant government assistance; and the minimal chances for travel and recreation. It is noteworthy that, despite the marked pessimism regarding the immediate situation in their respective countries, most participants (particularly the less-poor ones) believe that their countries will fare better in the coming years.

FINAL REMARKS

The present study confirms that both the recent food crisis and the financial and economic crisis have had significant negative effects on urban households in Central America. The food crisis struck the region in 2007 and mid-2008 while the financial and economic crisis came in late 2008 and in 2009, as shown by the behavior of various macroeconomic aggregates. Based on the qualitative analysis, there was broad consensus of opinion among nearly all focus group participants within and across countries. This pattern suggests that both crises had similar effects spanning the entire range of households in all of the four countries and, more generally, throughout Central America.

Central American families in urban areas, in particular, faced extraordinary increases in the prices of food staples, while in international markets real prices of the principal agricultural products reached highs unseen since the 1970s. Given this situation, the region's urban households chose various strategies to sustain, as much as possible, their levels of food consumption. First, they replaced some foods with others so as to rebalance their consumer baskets and minimize the impact on their spending budgets, while at the same time taking care not to neglect the need for proper nutrition. This substitution involved reducing consumption of more expensive foods, such as meat and high-quality branded products in favor of less expensive foods, such as stews and vegetables, and lower-quality brands. Middle-class homemakers, in particular, stated that they had started to frequent less expensive shopping centers instead of more exclusive ones. Second, more than a few households indicated that they had reduced their spending on other goods and services, such as recreation, in order to free up resources to maintain their spending on food. Third, there was consensus among a large majority of households that providing food for children must be given priority and that, where adjustments in food consumption must be made, the first changes should occur in adult consumption. At the same time, the qualitative analysis indicates that the negative effects of the crisis were not so severe as to produce widespread effects on children's health and school performance. Lastly, the perception of interviewees regarding food assistance provided by their respective governments was that such help occurs primarily through the public schools.

The study's findings on the impact of the financial and economic crisis highlighted the following effects: (1) loss of employment due to massive layoffs; (2) increased underemployment and "informalization" of labor relations; (3) increased number of small informal businesses to provide a means of subsistence in the absence of formal jobs; (4) adjustments in spending on

basic services and on education and health, particularly among the lower socioeconomic strata; (5) delay in investment projects; (6) reduction in the amount and frequency of remittances from abroad; (7) very limited or no capacity to save and limited access to formal credit; (8) greater use of informal forms of credit such as loans from relatives or acquaintances, and a system of rotating payments for basic services; (9) lack of government assistance to deal with the crisis; (10) worsening of personal relationships between household members; (11) general perception that the current economic situation is worse or considerably worse than in 2007; and (12) hope that the coming years will be better. At the country level, all participants agreed that their respective countries have experienced difficult times in the last two years.

In summary, Central American families in urban areas have borne a major portion of the economic adjustments needed to absorb the negative impact of the international crises. However, there needs to be an assessment of the actions taken by Central American governments to address and minimize the impacts of these crises, whether through social programs and/or

macroeconomic policies. With regard to social programs, there is the perception that they are inadequate, inasmuch as they are not widespread, although there is an implicit recognition that there have been major efforts to provide targeted aid. In terms of macroeconomic policies, a significant number of interviewees expressed the view that the governments are guilty of inaction. For example, there is the belief that governments are not taking concrete steps to boost employment or prevent business closures. Another factor worthy of mention is the labor flexibility, and capacity to “informalize” businesses, that exists in the countries analyzed. This suggests that Central American economies have flexibility in their economic structure and labor markets, which allows them to absorb external shocks through lower levels of open unemployment and smaller reductions in overall economic activity than would occur if such flexibility were not present. Nevertheless, the degree to which such flexibility and informality limits governments’ capacity to collect taxes and their ability to implement social assistance programs to address the situation remains to be determined.

NOTES:

1. While all four countries studied saw declines in international tourist and investment inflows in 2009, it can be argued that, even if the global crisis had not occurred, the figures for Honduras would be particularly low given the political crisis the country experienced during that year.
2. The econometric estimate is the result of estimating quarterly exports for the period from 2002 Q1 through 2008 Q2 as a function of one constant, one trend variable, and seasonal dichotomous variables. A prediction outside the sample was then made for the period from 2008 Q1 through 2009 Q3 to provide a basis for the projection.
3. For further details on the methodology, refer to Torero, Maximo, and Miguel Robles. 2010. “Understanding the Impact of High Food Prices in Latin America.” *Economía* 10 (2): 117–64. Although El Salvador is not addressed in that study, the simulations for it were derived following an identical methodology.
4. The simulated poverty increases in urban areas are higher than those in rural areas presumably because farmers who have a marketable food crop surplus can benefit from certain food price increases while urban consumers invariably suffer a loss of welfare.
5. Because each focus group was small (possibly influencing intragroup dynamics and/or heightening the effects of interpersonal influences) and participation was not based on strict random sampling, the insights gained should be viewed as suggestive of public views rather than as the result of a structured formal public opinion poll in urban areas.
6. In particular, increases in spending on food, as a proportion of total monthly spending, were evident in all socioeconomic strata in all four countries.
7. In El Salvador, the focus group participants further cited the fact that severance pay was sometimes given only partially; in other instances it was not given at all. In Guatemala, participants indicated that a number of *maquilas* simply vanished. In Honduras, several interviewees stated that the increase in minimum wage (amounting to nearly 60 percent in urban areas) at the beginning of 2009 also contributed to the loss of jobs.
8. In Guatemala, some participants stated that their children even had to leave the university, although they did not specify whether this was temporary or permanent. In Nicaragua, some participants mentioned that they had stopped going to private health centers and were instead using public health facilities.
9. In the case of El Salvador, Guatemala, and Honduras, the preferred destination continues to be the United States, while for Nicaraguans it is Costa Rica.

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FINANCIAL CONTRIBUTORS AND PARTNERS

IFPRI's research, capacity-strengthening, and communications work is made possible by its financial contributors and partners. IFPRI receives its principal funding from governments, private foundations, and international and regional organizations, most of which are members of the Consultative Group on International Agricultural Research (CGIAR). IFPRI gratefully acknowledges the generous unrestricted funding from Australia, Canada, China, Denmark, Finland, France, Germany, India, Ireland, Italy, Japan, the Netherlands, Norway, the Philippines, South Africa, Sweden, Switzerland, the United Kingdom, the United States, and the World Bank.

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